

***Tax Incentives***

**Rick Homans, Secretary  
N.M. Taxation and Revenue Department**

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## **Summary of Presentation**

- Perspectives on Tax Incentives
- Importance of Good Tax Incentive Design and Follow-up Analysis
- Steps We Are Taking at TRD

## **Perspectives on Tax Incentives**

- The other presentations on this panel will provide economists' perspectives on tax incentives.
- My perspective is shaped by my background as a businessman, as Secretary of Economic Development, as Director of the Spaceport, and now as Secretary-Designate of Taxation and Revenue.
- This background has given me “up close” experience with tax incentives:
  - I worked closely with clients of Economic Development to forge incentive packages that would entice the clients to locate or expand in New Mexico;
  - The Spaceport illustrates how incentives can successfully bring world-class, world-leading investment to New Mexico; and
  - Now at Taxation and Revenue, I am responsible for the administration of nearly all the tax incentives offered in New Mexico.
- While my perspective is different than those of professional economists, I don't think my perspective is “non-economic” or even a competing economic perspective.
- Rather, my perspective on tax incentives is simply from a different vantage point.
- That vantage point on tax incentives leads me to two broad conclusions:
  1. Good tax incentives work, as evidenced by New Mexico's economic development successes: from the cheese plant in Clovis, to cabinet manufacturing in Los Lunas, to many small economic-base business throughout the state, to the film industry, that has now taken hold in NM and is showing signs of solid growth.

2. Factors beyond tax incentives matter to business location and expansion decisions:

- Tax disincentives, such as pyramiding in the gross receipts tax, can discourage investment;
- The level and quality of public services affect business costs directly and through their ability to attract employees;
- The general cost structure, for labor, materials, transportation, and other items is a major driver of investment decisions; and
- “Quality of life” factors, most importantly the quality of education, are important to businessmen and their employees.

## **Importance of Good Tax Incentive Design and Follow-up Analysis**

- Good design is essential to tax incentives that work well, and good follow-up analysis is essential to making sure that in fact the incentive works well.
  - Good tax incentive design and follow-up analysis were a major priority for the Economic Development Department during my tenure as Secretary.
1. First, the Department, along with the state's business community, asked Public Works to prepare a study on New Mexico's economic development incentives and business tax structure in conjunction with the work of the Blue Ribbon Tax Reform Commission.
    - The study, "Bold and Effective Economic Development Incentives and Business Taxes That Work" was released in August 2003.
    - The key recommendation in the study was that "Improvement in the state's portfolio of economic development incentives must be considered in concert with reforms to the state's system of business taxation."
    - While I think New Mexico has made real progress on development incentives, much remains to be done on improving New Mexico's business tax system.
  2. Second, to insure the best possible design for the High-Wage Jobs Tax Credit, the Department asked Public Works to survey similar incentives around the country.
    - This survey, "High-Wage Job Business Tax Incentives" was prepared in September 2003.
  3. And, third, in the 2005 legislative session, Representative Mimi Stuart introduced HJM 11, which directed the Economic Development Department to convene a Task Force to review and make recommendations about how to develop a system for evaluating economic development incentives.
    - Although it did not pass, I endorsed the spirit of HJM 11 and with strong backing from the Governor formed a Task Force in June 2005 that included representatives from state agencies, legislative staff, and the private sector.
    - The agenda of the Task Force was to investigate policy, program design and implementation issues by reviewing current New Mexico

requirements, best practices nationally, research available in the field, and policies and programs in other states.

- To aid the work of the Task Force, EDD asked Public Works to prepare background information, “Survey of Business Incentives Assessment Methodologies and Best Practices”.
  - The Final Report of the Task Force, “New Mexico Economic Development Tax Incentive and Accountability Task Force Report” was released April 8, 2006.
  - The Report made a number of recommendations concerning the key incentives to be analyzed, the data required for analysis and how it should be collected, the methodology for analysis of economic impacts, and agency responsibilities.
  - A key finding was that “The starting point for any successful evaluation program is a clear law that outlines the information to be collected and the purpose of the subsequent data analysis.”
  - Primary responsibility for data collection and analysis was given to TRD, with adequate budget increases to cover these responsibilities.
  - What was clear to all of us is that the issue of Tax Incentive Reporting and Accountability is a very complicated one and there are serious issues regarding confidentiality, reporting mechanisms, recapture provisions, timelines, legislation – and budgeting the necessary funds to build a system that produces valid and usable results.
  - Based on studying best practices in other states, most notably North Carolina and Nebraska, we estimated in 2006 that the start-up cost of a good program in New Mexico would be about \$400,000. The recurring cost would be about \$400,000.
  - Anything less than a serious commitment to a project such as this could provide incomplete and distorted results and have serious and negative consequences.
- I would be happy to provide copies of these reports to members of the Committee.

## **Steps We Are Taking at TRD**

- The legislation contemplated by the Task Force concerning tax incentive data collection and the purpose of analysis has not yet been enacted, and TRD does not have the budgetary resources required for ongoing analyses.
- Nevertheless, TRD is committed to the analysis of tax incentives, and has taken a number of important steps to develop the infrastructure required for this work.
  1. All staff positions in TRD's Tax Analysis, Research and Statistics ("Tax Research") Office have been filled this year.
    - Two on our new economists have PhDs with specialties in resource economics, strengthening our ability to analyze energy-related tax incentives.
    - One new economist is completing his PhD, with the analysis of tax incentives serving as a portion of his dissertation research.
  2. Tax Research now has a dedicated server with essentially unlimited storage capacity for tax information on incentives and the background data needed to analyze incentives.
  3. The PCs for Tax Research staff have all been upgraded, as has the software available for data analysis.
  4. We have obtained one of the leading "hypothetical firm" models for analyzing tax incentives (and disincentives), the AFTAX model developed by Dr. James Papke, professor emeritus at Purdue University.
  5. We have begun work on the multi-year tax expenditure budget project that Jim Nunns will describe in his next presentation.
  6. We are developing a proposal for a "Credit Manager" which would help TRD administer credit applications and claims and provide data on credits in a much more timely and usable form to Tax Research and the Legislature.

On behalf of the Richardson Administration, I can assure you that we are all committed to performance measurements and accountability – and this applies to tax incentives as well.

I look forward to working with you to gain a better understanding of which incentives work, and which don't, as we move forward.